

1. CLEC Industry 1Q98 Summary

1Q CLEC Results Showed Continued Strong Topline Growth...

1Q results for the CLEC (competitive local exchange carrier) sector continued to show strong revenue growth for the period, up 57% year over year and 27% sequentially, led by slightly stronger than anticipated "core" CLEC revenues. We estimate that the CLECs' (including local efforts by LD companies) revenue share of the local telephone market stood at 3.5% at the end of March, an approximate 50 basis point increase over the 3.0% share garnered by 4Q97. We estimate that the CLEC share will increase to 5.4% by 4Q98.

In terms of annualized share gain, we estimate that during 1Q98 CLECs (including local efforts by LD companies) captured 0.47% of the current \$101Bn local market or an annualized share gain of 1.9%. This was an increase of 20 basis points over 4Q97's annualized share gain of 1.7%. We expect the CLECs' annualized share gain to increase to 2.6% of the \$105Bn local market by 4Q98.

... But Local Line Growth Trends Were Somewhat Disappointing

During 1Q98, CLECs as a group added 580,000 net local lines, a sequential increase of 11%. Growth in line adds during the quarter marked a slowdown, however, vs. the 67% & 24% sequential growth rates experienced in both 3Q97 and 4Q97. The lack of automated provisioning systems and electronic interface capabilities with the ILECs (incumbent local exchange carriers) continued to restrain the sequential ramp-up of the access line installation process. However, many CLECs are currently engaged in investment initiatives designed to upgrade and expand line provisioning capacity. These initiatives should help to alleviate these problems over the next quarter or two; thus we believe that quarterly access line additions will reverse the slowing sequential growth trend seen over the past 3 quarters and increase sequentially in future quarters. In fact, our forecast assumes that sequential line additions modestly accelerate to 12%, 13% and 14% during 2Q, 3Q and 4Q, respectively.

Progress on the EBITDA Front Restrained By The Funding of Backoffice and Growth Initiatives

For most of the publicly traded CLECs, while our revenue forecasts were met or exceeded, EBITDA losses were mainly in line with expectations as profitability for the period was impacted by continued heavy spending on backoffice systems (i.e., billing, line provisioning and customer service) and expansion of customer support personnel. These initiatives resulted in a number of negative revisions to our EBITDA forecasts for full year 1998 and 1999. In addition, we view these systems investments as necessary preparation for future revenue growth opportunities — such as data services — and believe their impact on EBITDA will decrease as revenues continue to grow rapidly.

Our Bullish Stance Towards The CLEC Group Is Supported By 5 Key Value Drivers

We maintain our bullish outlook on the CLEC group as a whole due to the attractive prospects for growth — both for top line and cash flow. We forecast that the local market opportunity available to the CLECs today is approximately \$105 billion and is forecast to grow at 4.0-4.5% per year. Our forecasted growth rates exceed historical levels due to rapid increases in internet usage fueling demand for second lines within the residential market and high speed data lines within the business market.

As the CLECs grow, we expect continued validation of the value creation mechanism via alliances and takeovers by other telecom companies including other CLECs, domestic local and long distance companies as well as non US-based telecom companies. These firms will be attracted to the sector given the strategic nature and scarcity of local telecom assets.

CLEC Stocks Weak, 19.2% Off Mid-March Highs

CLEC stocks have tracked the market year-to-date, significantly outperforming the market by 31.5% through mid-March but since then underperforming the market by 19.2%. We believe that the recent spate of weak relative stock price performance is as a result of the following factors:

- A period of stock price correction following an especially torrid run from December of 1997 through mid-March. As an example, on 12/5 we named Intermedia Communications our US focus stock for 1998. Following that, the stock outperformed the S&P 500 by 60.4% through the mid-March peak in the CLEC group;

- The lessening of euphoria concerning strong outlooks for data and internet traffic growth that culminated at our global telecom CEO conference in mid-March;
- Deceleration of quarterly local access line additions referred to above;
- A number of negative forecast revisions for EBITDA leading into the 1Q98 reporting season;
- Investor frustration following heated rumors that Bell Atlantic and Intermedia were close to a major out-of-region/inter-LATA data alliance, yet to be consummated; and,
- Reduced level of takeover speculation following the pending acquisition of Teleport Communications Group by AT&T (announced 1/8/98) which left many investors without an obvious "next target" given the dearth of CLECs deemed large enough to attract a suitor. This view gained further momentum through the late March-May time period as additional CLEC merger and acquisition activity failed to materialize.

*Look For 2H98 Catalysts To
Re-ignite CLEC Stock
Performance*

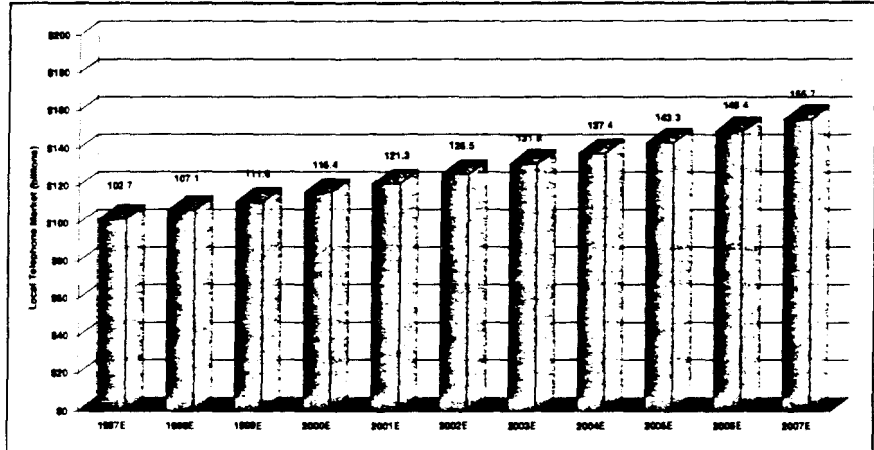
Potential catalysts for the CLEC stocks include a new wave of merger and acquisition activity, alliances with major telecom companies (i.e., Bell Atlantic and Intermedia out-of-region data alliance) and continued progress towards EBITDA breakeven for many CLECs. We view the current pull back in the CLEC group as an excellent buying opportunity and we reiterate our recommendations of Teligent (TGNT, D-2-1-9, \$28.00), Electric Lightwave (ELIX, D-2-2-9, \$13.13), and ICG Communications (ICGX, D-2-2-9, \$31.75). We are currently restricted from comment on Intermedia Communications (ICIX, RSTR, \$38.75), RCN Corporation (RCNC, RSTR, \$20.38), Advanced Radio Telecom (ARTT, RSTR, \$11.75) and Teleport (TCGI, RSTR, \$58.44).

2. Why We're Bullish On CLECs

We view the following five elements as the key value drivers supporting the fundamental outlook for the CLEC group:

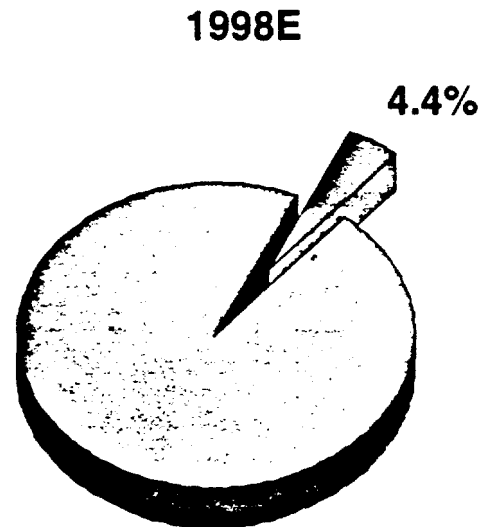
1. **A \$105 Billion Market Opportunity That The CLECs Have Only Just Begun To Exploit:** The local market opportunity available to the CLECs today is approximately \$105 billion and is forecast to grow at 4.0-4.5% per year (see Chart 1 below). However, the CLECs, in aggregate, have only accumulated an annualized market share of 2.1% for full-year 1997 — a market penetration that is expected to grow to 4.4% for full-year 1998, as shown in Chart 2 below.

Chart 1 — \$105 Billion Local Telecom Market Expected To Grow 4.0-4.5% Annually.



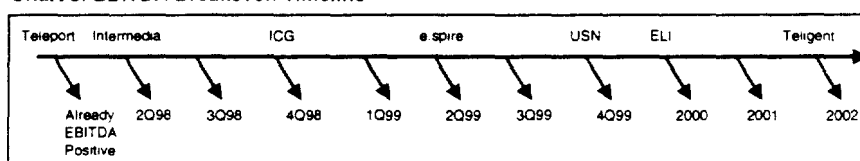
Source: Merrill Lynch estimates

Chart 2: 1998E Local Market Share Takeaway By New Entrants — CLEC & LD Co's



Source: Merrill Lynch estimates

- 1. Growth In The Local Market Continues To Exceed Forecast:** We continue to be positively surprised by the fundamental strength inherent in the local telecom market where reported year-over-year revenue growth trends in excess of 5% continue to exceed our 4.0-4.5% annual growth forecast. The key driving force underlying this observation remains the explosive demand evident in the data/internet markets with some additional support supplied by the continued strong customer demand for vertical features (e.g., voice mail and caller ID).
- 2. Profit Improvement With Continued Progress Towards EBITDA Break Even:** We view the achievement of EBITDA breakeven as an important milestone for all CLECs (except Teleport which is already EBITDA positive) on the road to self-funding and eventual bottom line profits. Chart 3 below details our forecast timetable for CLEC EBITDA break even.

Chart 3: EBITDA Breakeven Timeline

Source: Merrill Lynch estimates

- 4. Alliances Should Provide New Growth Opportunities:** Continued aggressive pursuit of partnerships (with other CLECs, electric utilities, ILECs, etc.) should bolster top line growth and both expand and accelerate development of the geographic footprint and product portfolio of the CLECs.
- 5. Consolidation, Consolidation, Consolidation:** Given the high costs and lengthy time to market delays associated with the construction of new local telecom networks, together with a highly receptive high yield bond market, we expect consolidation to remain an important theme in the CLEC group. To this point, we suspect that the smaller CLECs will consolidate amongst themselves in order to gain scale and scope, which may in turn, attract an acquirer. Likely buyers of CLECs include one of the large long distance companies in need of local facilities, other CLECs looking to increase geographic coverage, data skills and/or salesforce, or foreign-based telcos looking for "local presence" in the US and possibly, but less likely, ILECs desiring to move out of region.

Table 1: CLEC Company Comparisons

| Company | Rating | Price (6/17) | 1997 EPS | 1998E EPS | 1999E EPS | Price Obj. | % Upside | 1998E CAPX | 1998E EBITDA | 1Q98 Lines | 1998E Rev. |
|--------------------|---------|-----------------|-------------|--------------|--------------|------------|----------|---------------|-----------------|---------------|---------------|
| ART | RSTR | \$11.75 | (\$2.26) | RSTR | RSTR | RSTR | RSTR | RSTR | RSTR | NM | RSTR |
| Electric Lightwave | D-2-2-9 | \$13.13 | (\$0.66) | (\$1.50) | (\$3.06) | \$20.00 | 52% | 270M | (49)M | 41,270 | 100.5M |
| e.spire | D-2-1-9 | \$17.38 | (\$4.65) | (\$3.61) | (\$2.96) | \$28.00 | 61% | 160M | (35)M | 57,500 | 156.4M |
| ICG | D-2-2-9 | \$31.75 | (\$9.75) | (\$6.34) | (\$6.39) | \$42.00 | 32% | 400M | (31)M | 186,100 | 562.0M |
| Intermedia Comm. | RSTR | \$38.75 | (\$10.83) | RSTR | RSTR | RSTR | RSTR | RSTR | RSTR | 221,000 | RSTR |
| RCN Corp | RSTR | \$20.38 | (\$2.50) | RSTR | RSTR | RSTR | RSTR | RSTR | RSTR | 40,500 | RSTR |
| Teligent | D-2-1-9 | \$28.00 | NA | (\$3.47) | (\$3.49) | \$37.00 | 32% | 170M | (113)M | NA | 2.0M |
| Teleport Comm. | RSTR | \$58.44 | (\$1.34) | RSTR | RSTR | NA | RSTR | RSTR | RSTR | 326,000 | RSTR |
| USN | D-3-2-9 | \$8.25 | (\$15.55) | (\$9.00) | (\$4.73) | \$18.00 | 118% | 25 M | (132)M | 226,000 | 238.4M |

Source: Merrill Lynch estimates and company reports

*Access line counts adjusted to reflect profitability of lines based on transmission method (on-net, UNE, or TSR)

3. 1Q98 CLEC Review

The CLEC sector continued to show strong revenue growth during 1Q98. On average, "core" CLEC revenue growth slightly exceeded our forecasts for the quarter. Nevertheless, for most of the publicly traded CLECs, EBITDA losses did not beat our forecasts as profitability for the period was restrained by continued heavy spending on backoffice systems (i.e., billing, line provisioning and customer service) and expansion of customer support personnel. Highlights of the quarter are as follows:

*Strong Sequential Growth Seen
In Core CLEC Revenues*

Data, Data, Data

Revenue Performance

During 1Q, we were impressed with the strong growth in local switched services revenue reported by the CLECs. Although net local access line growth was below our expectations, the CLECs, on average, met or exceeded our corporate revenue estimates aided, in part, by strong customer demand for data services.

Most CLECs view data services as serving a dual role: data expands the portfolio of services offered to customers and also helps to "jump start" commercial operations in new markets.

Data related highlights of the quarter include:

- Intermedia signed an agreement to be US West's preferred provider of data communications both in and out of US West territory on a wholesale basis (Intermedia recently signed a similar deal with Ameritech on 5/19); and
- ICG announced several new data initiatives which will be kicking off in mid-July including IP (internet protocol) long distance service and high speed internet access over DSL. "Digital subscriber line" technology permits the provision of services requiring high bandwidth capacity via twisted-pair copper wires.

Other CLECs such as Electric Lightwave and e.spire (formerly American Communication Services Inc. or ACSI) view data services as a key component in their integrated services offering and these services played important roles in 1Q98 top line performance with sequential data revenue growth of 24% for Electric Lightwave and 16% for e.spire Communications.

Table 2: Quarterly & Annual Revenue Growth (\$ in millions)

| | 4Q97 | 1Q98 | Sqt'l Growth | | | Full Year | | Annual Growth |
|------------|------|------|--------------|------|------|-----------|-------|---------------|
| | | | 3Q97 | 4Q97 | 1Q98 | 1997 | 1998E | |
| ELI | \$19 | \$20 | NA | NA | 5% | \$61 | \$101 | 65% |
| e.spire | 23 | 28 | 38% | 45% | 22% | 59 | 156 | 165% |
| GST* | 28 | 30 | NA | 17% | 7% | 119 | NA | NA |
| Hyperion | 5 | NA | NA | NA | NA | 21 | NA | NA |
| ICG | 78 | 126 | NA | 15% | 62% | 273 | 603 | 121% |
| Intermedia | 83 | 137 | NA | 16% | 65% | 248 | RSTR | RSTR |
| McLeod | 136 | 134 | (18%) | 176% | (1%) | 268 | NA | NA |
| NEXTLINK | 23 | 27 | NA | 68% | 17% | 58 | NA | NA |
| RCN | 20 | 43 | NA | NA | 115% | 127 | RSTR | RSTR |
| TCG | 150 | 160 | 14% | 14% | 7% | 494 | RSTR | RSTR |
| US LEC | 5 | 14 | NA | NA | 180% | 6 | NA | NA |
| USN | 20 | 32 | NA | 80% | 60% | 47 | 301 | 537% |
| WinStar | 30 | 47 | NA | 49% | 57% | 79 | NA | NA |
| Total | 620 | 798 | NM | NM | NM | 1,860 | NM | NM |

*Net of NACT EBITDA contribution as NACT ownership was monetized during 2/98

Source: Merrill Lynch estimates and company reports

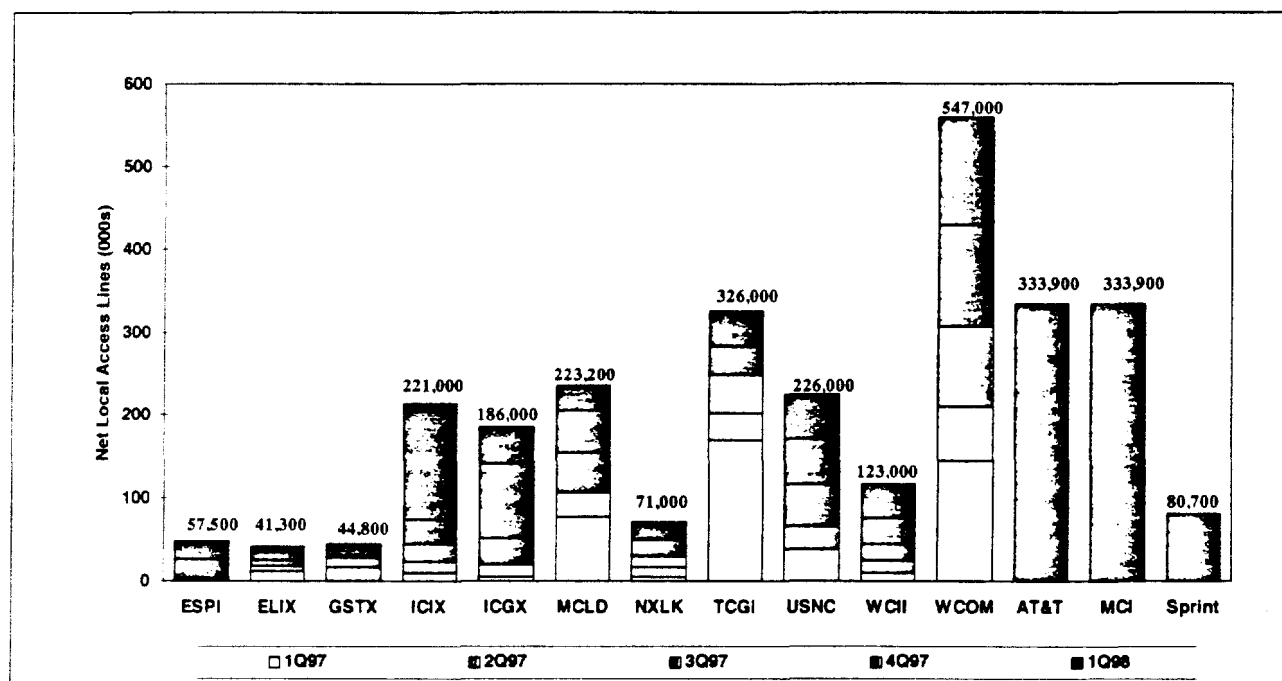
*USN Led The Independent
CLECs With 54,000 Access
Lines Installed During 1Q*

1Q Access Lines

As shown in Chart 4 below, USN and ICG had the strongest net incremental local access line installations of the independent CLECs during 1Q. USN installed 54,000 net access lines, in line with 4Q results and ended the quarter with a total of 226,000 access lines in service. ICG increased its quarterly installations from 40,000 in 4Q to 45,000 with a total of 186,000 access lines in service. e.spire Communications installed 22,400 access lines during 1Q, an increase of 49% over the 15,000 installed during 4Q, ending the quarter with 57,500 lines in service. In addition, the local divisions of WorldCom, MFS and Brooks combined to install a total of 130,000 access lines during the quarter, bringing WorldCom's total access lines in service to 547,000.

Excluding acquisitions, Intermedia installed 27,600 access lines, 11% below our expectations, ending the quarter with 221,000 access lines in service including 111,600 access lines acquired from Shared Technologies. During 1Q, Teleport installed 43,000 net access lines with a total of 326,000 in service. Electric Lightwave installed approximately 7,000 access lines, a decline from the 9,000 installed during 4Q. We attribute the slowdown in Electric Lightwave's access line installations to heavy reliance on T-1 connections leased from US West, however, the company expects that the delays will be resolved with the settlement of Electric Lightwave's anti-trust case against US West expected in the next few months.

Chart 4: Net Local Access Lines In Service At End of 1Q98*

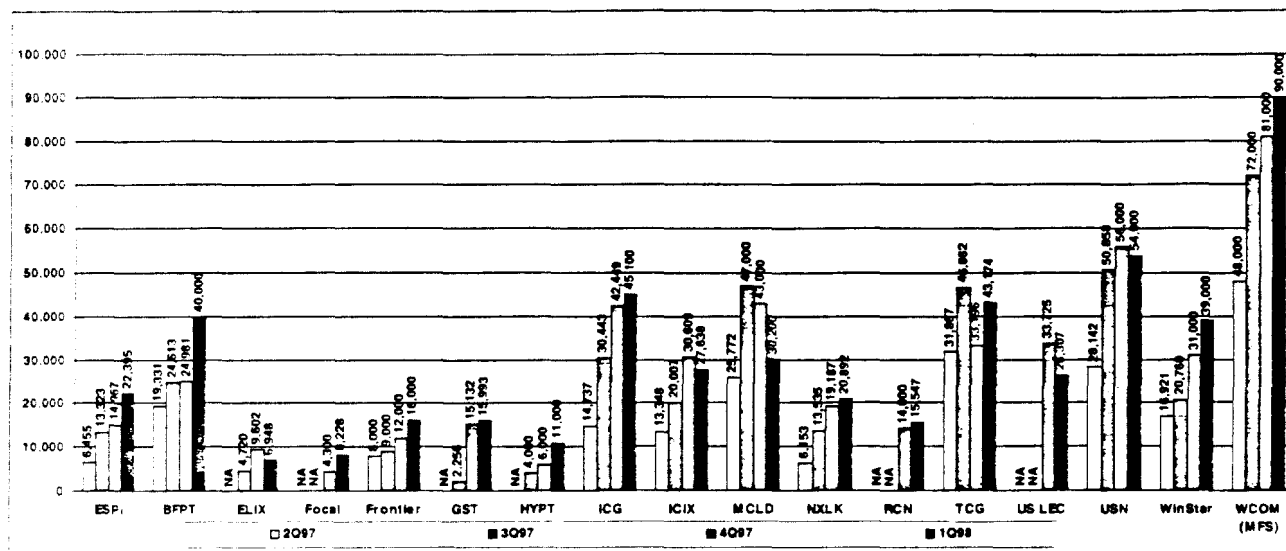


*Includes gained through acquisitions: 1Q98 - 111,600 from Intermedia's acquisition of Shared Tech, 1,811 from NEXLINK's acquisition of Start Technologies, 24,000 from WmStar's acquisition of Goodnet & Pacnet; and 4Q97 - 8,000 from McLeod's acquisition of Consolidated & 48,000 from ICG's acquisition of CBG.

LD access line count based on 1997 switched revenues \$100M AT&T, \$100M MCI, \$25M Sprint and \$64 monthly revenue per line; and 1998 switched revenues \$300M AT&T, \$300M MCI, \$75M Sprint and \$65 monthly revenue per line.

Source: Merrill Lynch estimates and company reports.

Chart 5: CLEC Organic Line Additions*



*Net of lines gained through acquisition including: 1Q98: 111,600 from Intermedia's acquisition of Shared Tech, 1,811 from NEXLINK's acquisition of Start Technologies, 24,000 from WinStar's acquisition of Goodnet & Pacnet, and: 4Q97: 8,000 from McLeod's acquisition of Consolidated & 48,000 from ICG's acquisition of CBG.

Source: Company reports and Merrill Lynch estimates

RCN Ended 1Q With An Impressive 16% Penetration Into Homes Passed By Its Advanced Fiber Network

RCN is unique in the CLEC industry with its marketing focus primarily directed to the residential market instead of the business orientation of the other CLECs. To further distinguish the company from other CLECs, RCN is pursuing a facilities based strategy and building out an "advanced fiber" network of hybrid fiber coax and twisted copper pairs to its residential customers. Unit growth analysis for RCN, therefore, focuses on both customer connections and the number of homes passed by its advanced fiber network. As shown in Table 3 below, RCN exceeded our expectations in almost all categories and ended 1Q with 63,386 homes passed by its advanced fiber network with an average of 2 service connections per subscriber, this equates to 10,200 homes served or 16% penetration of the 63,386 homes passed by RCN's network (see row O in Table 2 below).

Table 3: RCN Connections & Penetration

| | | 4Q97 | 1Q98 | Sq'l Growth |
|-------------|-----------------------------|---------|---------|-------------|
| A | Homes Passed | 44,045 | 63,386 | 44% |
| | On-Net | | | |
| B | Voice | 3,214 | 4,473 | 39% |
| C | Video | 11,784 | 15,599 | 32% |
| D | Data | 150 | 267 | 78% |
| E (sum B:D) | Total On-Net | 15,148 | 20,339 | 34% |
| | Off-Net | | | |
| F | Voice | 24,900 | 40,447 | 62% |
| G | Video | 227,619 | 227,558 | NM |
| H | Data | | 370,271 | NM |
| I (sum F:H) | Total Off-Net | 252,519 | 638,276 | NM |
| J (E+I) | Total Service Connections | 267,767 | 658,615 | NM |
| | Penetration Of Homes Passed | | | |
| K (B/A) | Voice | 7% | 7% | |
| L (C/A) | Video | 27% | 25% | |
| M (D/A) | Data | 0% | 0% | |
| N | Services Per Customer | 2 | 2 | |
| O (E/N/A) | Total On-net Penetration | 17% | 16% | |

Source: Merrill Lynch estimates and company reports.

4. Line Mix

Line Mix Is Crucial To Gross Margins

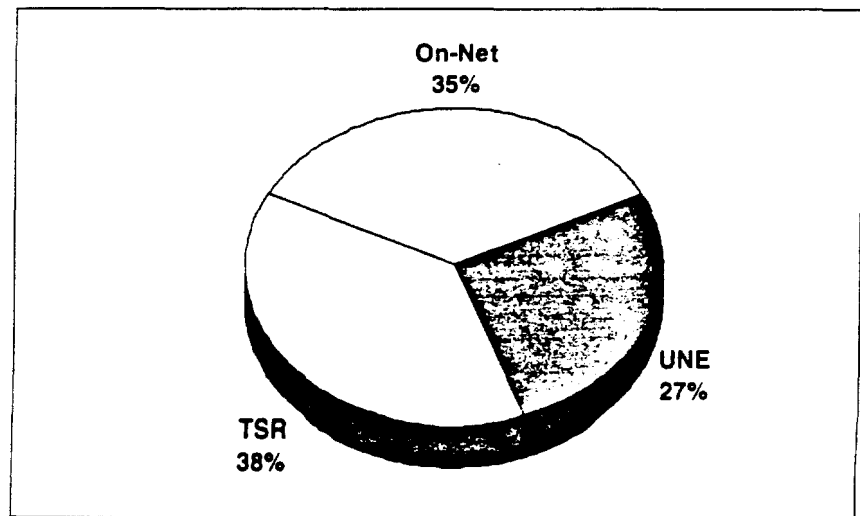
Table 4 and Chart 6 below detail our estimates of line mix for the CLECs' access lines in service at 1Q. We estimate that the average mix of lines in service during 1Q was 35% via on-net, 27% via UNE, and 38% via TSR, which compares to our estimate of 37% on-net, 28% UNE, and 35% TSR for 4Q97. We believe CLEC line mix will continue to trend more towards on-net and UNE transmission as CLEC local network reach expands due to continued facilities buildout.

Table 4: Estimated 1Q98 CLEC Line Mix

| | On-net | UNE | TSR | Total |
|-------------------------|------------|------------|------------|-------------|
| e.spire | 19% | 0% | 81% | 100% |
| Brooks Fiber | 60% | 35% | 5% | 100% |
| Electric Lightwave | 74% | 23% | 3% | 100% |
| Focal | 0% | 90% | 10% | 100% |
| Frontier | 0% | 2% | 98% | 100% |
| GST | 10% | 50% | 40% | 100% |
| Hyperion | 0% | 86% | 14% | 100% |
| ICG | 48% | 14% | 38% | 100% |
| Intermedia | 40% | 20% | 40% | 100% |
| McLeod | 0% | 10% | 90% | 100% |
| NEXTLINK | 20% | 75% | 5% | 100% |
| RCN | 15% | 0% | 85% | 100% |
| Teleport | 80% | 20% | 0% | 100% |
| US LEC | 0% | 100% | 0% | 100% |
| USN | 0% | 0% | 100% | 100% |
| WinStar | 15% | 5% | 80% | 100% |
| WorldCom (MFS) | 75% | 25% | 0% | 100% |
| AT&T (Local) | 20% | 15% | 65% | 100% |
| MCIMetro | 50% | 50% | 0% | 100% |
| Sprint (Local) | 0% | 30% | 70% | 100% |
| Weighted Average | 35% | 27% | 38% | 100% |

Source: Merrill Lynch estimates

Chart 6: 1Q98 Estimated CLEC Industry Weighted Average Line Mix



Source: Merrill Lynch estimates

Line mix is a critical variable in analyzing the true fundamental performance of a CLEC because each local access method provides the ability to attain a different EBITDA margin. In general, CLECs provide local network connectivity to customers through one of the following three methods (for a graphical depiction, please see charts 7A-C below). Our derivation of potential EBITDA margins is shown in Table J.:

- **On-net:** These access lines are provided 100% over the CLEC's own facilities including last mile either through wireline or wireless transmission; with a potential 40% EBITDA margin, over time, for local switched revenues;
- **Unbundled network elements (UNE):** These access lines are provided over a combination of CLEC owned and leased facilities (especially last mile loops) from the ILEC with a potential 25% EBITDA margin, over time, for local switched revenues; and,
- **Total service resale (TSR):** These access lines are provided 100% over leased ILEC facilities; with a potential 5% EBITDA margin, over time, for local switched revenues.

Chart 7a: On-net Schematic

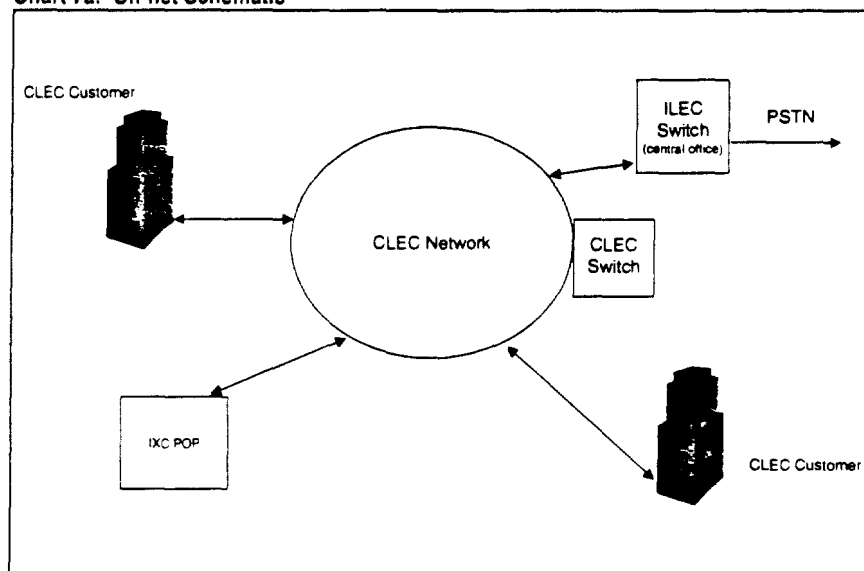
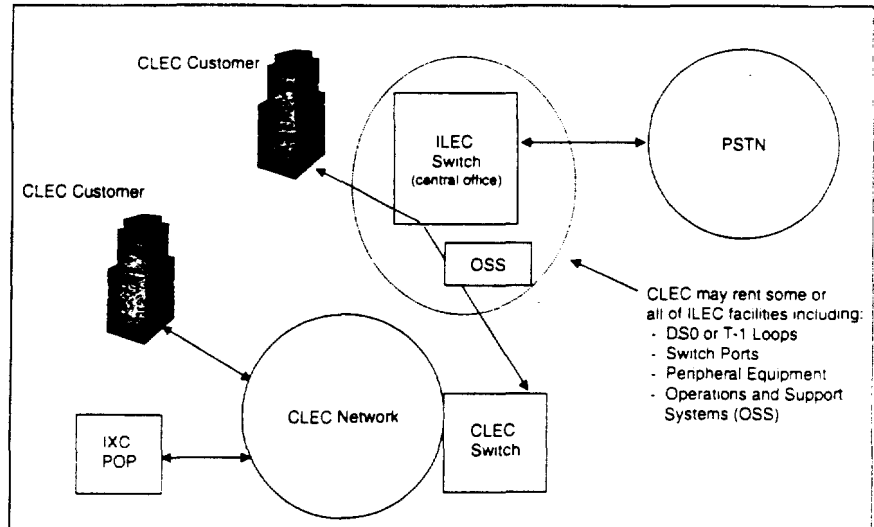
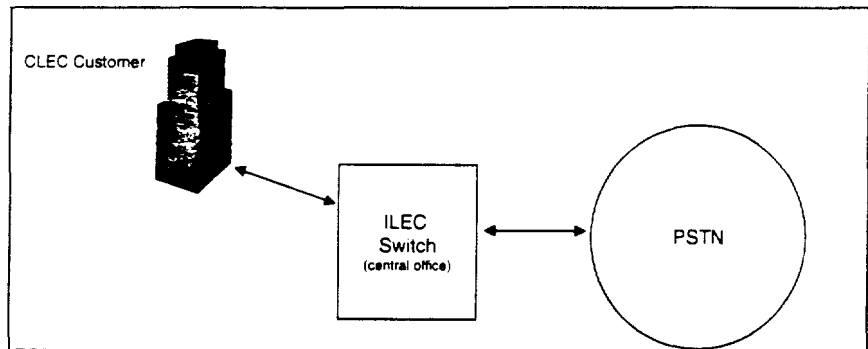


Chart 7b: Unbundled Network Element (UNE) Schematic**Chart 7c: Total Service Resale (TSR) Schematic**

Source: Merrill Lynch

Table 5: Estimated CLEC EBITDA Margins By Method Of Local Market Entry — 2007

| | TSR | USN TSR | UNE | On-net |
|----------------------|-----------|--------------|------------|------------|
| Revenue | 100% | 100% | 100% | 100% |
| Discount | 5% | 5% | 10% | 15% |
| Network Costs | 80% | 61.5% | 50% | 25% |
| SG&A | 10% | 22% | 15% | 20% |
| EBITDA | 5% | 11.5% | 25% | 40% |
| Interest | — | — | 4% | 7% |
| Depreciation | — | 1.5% | 5% | 10% |
| Pretax Margin | 5% | 10.0% | 16% | 23% |

Source: Merrill Lynch estimates

5. Tracking/Predicting Pace Of Share Gain

■ CLEC Annualized Local Revenues and Access Line Market Share Gains

*CLECs & LD Co's
Accumulated An Annualized
1.9% Share Gain Of The
Estimated \$101 Billion Local
Market During 1Q*

We estimate that during 1Q98, the local competitors (that is, the CLECs and the big 3 long distance companies: AT&T, MCI and Sprint) accumulated an annualized 1.9% share gain of the estimated \$101 billion US local market (see Table 6 below). This was an 18 basis point improvement over the 1.7% annualized share gained during 4Q97, but marked a deceleration vs. prior quarters. However, we expect the local competitors' annualized share gains to increase during the next few quarters as salesforce and access line provisioning productivity ramps up, with annualized share gain forecasted to reach 2.6% by 4Q98.

Methodology:

In order to determine the annual local services revenues earned by the local competitors, we divided local revenues into two categories: switched and dedicated services.

The estimates for dedicated services revenues are based on our individual 10-year company models (located in the appendix of this report) and are also detailed in Table 7 below. Our forecasts of switched services revenue are based upon our estimates of quarterly access line additions multiplied by estimated monthly revenue per line.

We use the following methodology to determine the local competitors' annualized share gain of local dedicated and switched services revenues (all calculations are shown in Table 6 below, unless otherwise noted):

1. (Row CC): Total organic access line additions (row X) x 4 x monthly revenue per line (row BB) = **local competitors monthly incremental switched revenue**;
2. (Row DD): Incremental quarterly dedicated services revenues (Table 6) ÷ 3 = **monthly incremental dedicated revenue**;
3. (Row EE): Monthly switched revenue (row CC) + monthly dedicated revenue (row DD) = **total local competitors' local revenue**;
4. (Row FF): Total local competitors local revenue (row EE) x 12 = **annualized local competitors' incremental local revenue**;
5. (Row GG): **Estimated US local revenue** (our estimate); and,
6. (Row HH): Local competitors annualized local revenue gain ÷ US local revenue = **local competitors' share gain**

Our methodology makes it possible to compare the quarterly and annual local market share gains of companies on a consistent basis, however, the forecasts within the tables may differ slightly from the forecasts within individual company models, due to the use of a "standardized" monthly revenue per line forecast.

Table 6: CLEC & LD Co's Access Line Market Share Gains

| | Company | 2Q97 | 3Q97 | 4Q97 | 1Q98 | 2Q98E | 3Q98E | 4Q98E |
|------------|---|---------------|---------------|---------------|---------------|---------------|----------------|----------------|
| A | espire | 6,455 | 13,323 | 14,967 | 22,395 | 26,105 | 30,000 | 35,000 |
| B | Brooks Fiber | 19,331 | 24,613 | 24,981 | 40,000 | 50,000 | 55,000 | 60,000 |
| C | Electric Lightwave | 5,329 | 4,720 | 9,602 | 6,948 | 9,000 | 12,000 | 15,000 |
| D | Focal | NA | 2,000E | 4,300 | 8,228 | 10,000 | 12,500 | 15,000 |
| E | Fronter | 8,000 | 9,000 | 12,000 | 16,000 | 18,000 | 21,000 | 24,500 |
| F | GST | NA | 2,256 | 15,132 | 15,993 | 16,500 | 17,000 | 17,500 |
| G | Hyperion | 1,000E | 4,000E | 6,000E | 11,000 | 14,000 | 19,000 | 24,000 |
| H | ICG* | 14,737 | 30,443 | 42,449 | 45,100 | 46,900 | 53,000 | 58,000 |
| I | Intermedia* | 13,348 | 20,007 | 30,609 | 27,638 | 40,413 | 43,000 | 45,000 |
| J | McLeod* | 25,772 | 47,000 | 43,000 | 30,200 | 32,000 | 34,000 | 36,000 |
| K | NEXLINK* | 6,153 | 13,535 | 19,187 | 20,892 | 22,000 | 24,000 | 26,000 |
| L | RCN* | NA | 10,900 | 14,000 | 15,547 | 16,500 | 18,500 | 22,000 |
| M | Teleport | 31,867 | 46,862 | 33,196 | 43,174 | 46,000 | 50,000 | 55,000 |
| N | US LEC | 4,087 | 11,417 | 33,725 | 26,307 | 28,000 | 30,000 | 32,000 |
| O | USN | 28,142 | 50,858 | 56,000 | 54,000 | 50,000 | 70,000 | 80,000 |
| P | WinStar* | 16,921 | 20,760 | 31,000 | 39,000 | 45,000 | 50,000 | 57,000 |
| Q | WorldCom (MFS) | <u>48,000</u> | <u>72,000</u> | <u>81,000</u> | <u>90,000</u> | <u>95,000</u> | <u>100,000</u> | <u>110,000</u> |
| R sum(A-Q) | Total CLEC Lines | 229,142 | 383,694 | 471,148 | 512,422 | 582,418 | 669,000 | 782,000 |
| S | AT&T (Local)** | 8,000 | 15,000 | 22,000 | 30,000 | 37,500 | 42,500 | 55,000 |
| T | MCIMetro** | 8,000 | 15,000 | 22,000 | 30,000 | 37,500 | 42,500 | 55,000 |
| U | Sprint (Local)** | <u>6,000</u> | <u>6,500</u> | <u>7,000</u> | <u>7,500</u> | <u>9,375</u> | <u>10,625</u> | <u>13,750</u> |
| V sum(S-U) | Total LD Lines | 22,000 | 36,500 | 51,000 | 67,500 | 78,100 | 88,900 | 99,800 |
| W (R-V) | Total Organic Lines Added (excluding acquisition) | 251,142 | 420,194 | 522,148 | 579,922 | 649,793 | 734,625 | 835,750 |
| | Sequential Growth | | 67% | 24% | 11% | 12% | 13% | 14% |

Sequential Growth In Line
Additions Should Re-Accelerate

| | | | | | | | | |
|----------------------------------|--|---------|---------|---------|---------|---------|---------|---------|
| US Access Line Share Gain | | | | | | | | |
| X (W) | Total Organic Line Additions | 251,142 | 420,194 | 522,148 | 579,922 | 649,793 | 734,625 | 835,750 |
| Y our est | Est. Total US Access Lines (millions) | 168 | 169 | 170 | 172 | 173 | 175 | 177 |
| Z (X-Y) | % of Total US Access Lines | 0.15% | 0.25% | 0.31% | 0.34% | 0.37% | 0.42% | 0.47% |
| AA (Z-X) | Local Competitors' Annualized Share Gain | 0.60% | 0.99% | 1.23% | 1.35% | 1.50% | 1.68% | 1.89% |
| | Incremental Annualized Share Gain (basis points) | | 40 | 23 | 12 | 15 | 18 | 21 |

| | | | | | | | | |
|---|---|----------|----------|-----------|-----------|-----------|-----------|-----------|
| Local Competitor Local Revenue Share Gain (millions) | | | | | | | | |
| BB our est | Avg. Mo. Local Revenue/Line (0.5% sqtl. increase) | \$ 63.04 | \$ 63.36 | \$ 63.68 | \$ 64.00 | \$ 64.32 | \$ 64.64 | \$ 64.96 |
| CC (Xx4XB) | Monthly Incremental Switched Revenue*** | \$63 | \$106 | \$133 | \$148 | \$167 | \$190 | \$217 |
| DD (Table 7) | Monthly Incremental Dedicated Revenue | \$6 | \$5 | \$10 | \$11 | \$11 | \$11 | \$11 |
| EE (CC-DD) | Total Monthly Incremental Local Revenue | \$70 | \$112 | \$143 | \$159 | \$178 | \$201 | \$228 |
| FF (EEx12) | Annualized Incremental Local Revenue | 836 | 1,340 | 1,717 | 1,913 | 2,134 | 2,407 | 2,734 |
| GG our est | Est Total US Local Switched & Dedicated Revenue | \$98,000 | \$99,000 | \$100,000 | \$101,000 | \$102,000 | \$103,000 | \$105,000 |
| HH (FF/GG) | Local Competitors' Annl'z'd Share Gain of US Local Rev. | 0.85% | 1.35% | 1.72% | 1.89% | 2.09% | 2.34% | 2.60% |
| | Incremental Annualized Share Gain (basis points) | | 50 | 36 | 18 | 20 | 24 | 27 |

*Excludes acquired lines: 1Q98 111,600 from Intermedia's acquisition of Shared Tech, 1,811 from NEXLINK's acquisition of Start Technologies, 24,000 from WinStar's acquisition of Goodnet & Pacnet; and 4Q97 8,000 from McLeod's acquisition of Consolidated & 48,000 from ICG's acquisition of CBG.

** LD access line count based on 1997 switched revenues of \$100M AT&T, \$100M MCI, \$25M Sprint and \$64 monthly revenue per line; and 1998 switched revenues \$300M AT&T, \$300M MCI, \$75M Sprint and \$65 monthly revenue per line.

***Forecasts may differ slightly from forecasts within individual company models due to the use of "standardized" monthly revenue per line numbers.
Source: Merrill Lynch estimates and company reports

Table 7: Dedicated Access Revenues (Estimated)

| Special Access | 1Q97A | 2Q97A | 3Q97A | 4Q97A | 1997A | 1Q98A | 2Q98E | 3Q98E | 4Q98E | 1998E |
|-----------------------|--------------|--------------|--------------|--------------|----------------|--------------|--------------|--------------|--------------|----------------|
| espire | 3.8 | 6.0 | 7.0 | 8.2 | 25.0 | 8.5 | 9.3 | 10.1 | 11.0 | 38.9 |
| Brooks Fiber | 13.8 | 13.8 | 13.8 | 13.8 | 43.5 | 15.0 | 20.0 | 23.0 | 25.0 | 83.0 |
| Electric Lightwave | 5.0 | 5.3 | 6.0 | 7.2 | 23.5 | 6.4 | 6.9 | 7.5 | 8.2 | 29.0 |
| Focal | 0.2 | 0.2 | 0.2 | 0.2 | 0.6 | 0.1 | 0.1 | 0.1 | 0.2 | 0.5 |
| GST | 4.0 | 5.0 | 7.0 | 8.0 | 24.0 | 8.0 | 10.0 | 12.0 | 14.0 | 44.0 |
| Hyperion | 0.3 | 0.3 | 0.3 | 0.3 | 1.0 | 0.5 | 0.8 | 1.1 | 1.5 | 3.9 |
| ICG | 12.1 | 13.5 | 14.4 | 15.5 | 55.4 | 16.1 | 17.2 | 18.1 | 18.9 | 70.3 |
| Intermedia | 1.6 | 2.5 | 3.5 | 5.0 | 12.6 | 10.1 | 11.7 | 13.4 | 15.6 | 50.8 |
| McLecc | - | - | - | - | - | - | - | - | - | - |
| NEXTLINK | 2.0 | 2.2 | 3.0 | 3.5 | 10.7 | 7.0 | 11.0 | 13.0 | 15.0 | 46.0 |
| RCN | - | - | - | - | - | - | - | - | - | - |
| Teleport | 51.3 | 59.7 | 63.5 | 76.8 | 251.3 | 73.9 | 78.2 | 83.0 | 88.4 | 323.6 |
| US LEC | - | - | - | - | - | - | - | - | - | - |
| USN | - | - | - | - | - | - | - | - | - | - |
| WinStar | 6.5 | 6 | 6.5 | 7 | 25.0 | 5.0 | 7.5 | 10.0 | 15.0 | 37.5 |
| WorldCom (MFS) | 25.0 | 30.0 | 35.0 | 45.0 | 135.0 | 50.0 | 60.0 | 70.0 | 80.0 | 260.0 |
| AT&T (Local) | 50.0 | 50.0 | 50.0 | 50.0 | 200.0 | 60.0 | 60.0 | 60.0 | 60.0 | 240.0 |
| MCI Metro | 50.0 | 50.0 | 50.0 | 50.0 | 200.0 | 60.0 | 60.0 | 60.0 | 60.0 | 240.0 |
| <u>Sprint (Local)</u> | <u>12.5</u> | <u>12.5</u> | <u>12.5</u> | <u>12.5</u> | <u>50.0</u> | <u>15.0</u> | <u>15.0</u> | <u>15.0</u> | <u>15.0</u> | <u>60.0</u> |
| Total | 237.9 | 257.0 | 272.6 | 302.8 | 1,057.6 | 335.6 | 367.7 | 396.3 | 427.9 | 1,527.5 |

Source: Merrill Lynch estimates

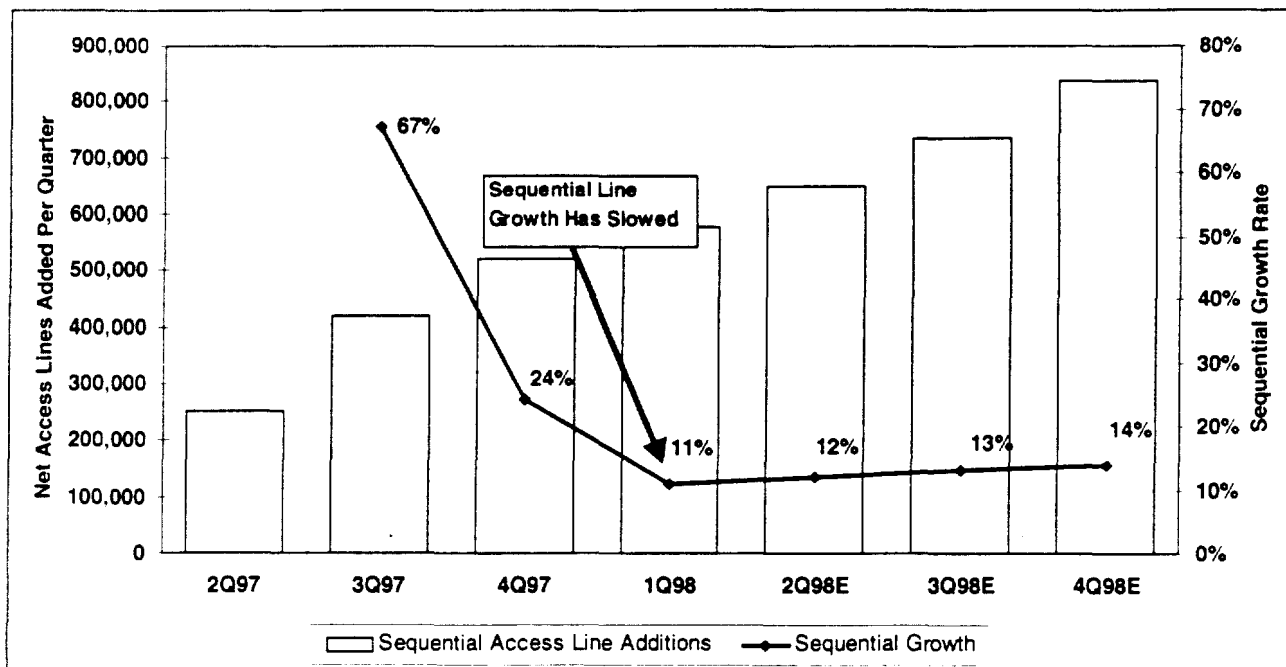
*1Q Annualized Local Access
Line Share Gains Totaled 1.4%*

*1Q98 Saw CLEC Local Line
Additions Of 579,922, Up 11%
Vs. The 522,148 Lines Added
During 4Q97*

As shown in Table 6 above, we estimate that the CLECs' annualized share gain during 1Q was 1.4% of local access lines, an increase of 12 basis points over 4Q97. We forecast that the CLECs' annualized line share gain will accelerate during the next few quarters, reaching 1.9% by 4Q98.

As detailed in Table 6 above and Chart 8 below, during 1Q, net line addition growth declined vs. 3Q and 4Q97 as CLEC line additions grew sequentially by only 11% during 1Q compared to 4Q97's 24% growth. While we were disappointed by this slowdown in sequential access line growth, we believe that the downward trend will reverse itself during the next few quarters as the CLECs ramp up functionality and capacity in installation and billing systems with the local competitors in aggregate reaching a 14% sequential growth rate in local access line additions by 4Q98.

Chart 8: Sequential Growth In CLEC Line Adds Decelerated In 1Q...But Should Modestly Accelerate Throughout 1998*



*Based on "organic" or internally generated line growth, excluding lines added via merger or acquisition
 Source: Merrill Lynch estimates

■ Share of US Local Revenue & Access Lines

We estimate The CLECs Share Stood at An Annualized 3.5% of US Local Revenues By 1Q98

At 1Q, We Estimate 3.1 Million Local Lines Were Served By CLECs & Big LD Carriers, Equating To 1.7% Of Total US Access Lines

We estimate that the CLECs (including local efforts by LD companies) accumulated a 3.5% of the US local market by 1Q, an approximate 50 basis point increase over the 3.0% share garnered by 4Q97. As shown in Table 8 below, we estimate that the CLEC share will increase to 5.4% by 4Q98.

As of 1Q, the local competitors in aggregate had approximately 2.9 million local lines in service, equating to 1.7% of the estimated 177 million local access lines in service in the US market. We estimate that local competitors' access lines in service will grow by over 75% over the next 3 quarters, reaching 5.1 million local lines in service by the end of 4Q98, equating to 2.9% of US local access lines. Table 8 below details the actual net access lines in service at quarter-end as well as our quarterly line forecast for 1998.

Table 8: Local Competitors' Annualized Share of Local Access Lines* & Revenues

| | | 4Q97A | 1Q98A | 2Q98E | 3Q98E | 4Q98E |
|---|---|----------------|----------------|----------------|----------------|----------------|
| A | e spire | 35,105 | 57,500 | 83,605 | 113,605 | 148,605 |
| B | Brooks Fiber | 105,000 | 145,000 | 195,000 | 250,000 | 310,000 |
| C | Electric Lightwave | 34,322 | 41,270 | 50,270 | 62,270 | 77,270 |
| D | Focal | 6,300 | 14,528 | 24,528 | 37,028 | 52,028 |
| E | Frontier | 100,000 | 116,000 | 134,000 | 155,000 | 179,500 |
| F | GST | 28,853 | 44,846 | 61,346 | 78,346 | 95,846 |
| G | Hyperion | 25,000 | 36,000 | 50,000 | 69,000 | 93,000 |
| H | ICG*** | 93,000 | 138,100 | 185,000 | 238,000 | 296,000 |
| I | Intermedia*** | 81,349 | 108,987 | 149,400 | 192,400 | 237,400 |
| J | McLeod*** | 193,000 | 223,200 | 255,200 | 289,200 | 325,200 |
| K | NEXTLINK*** | 50,131 | 71,023 | 93,023 | 117,023 | 143,023 |
| L | RCN* | 24,900 | 40,447 | 56,947 | 75,447 | 97,447 |
| M | Teleport | 282,700 | 325,874 | 371,874 | 421,874 | 476,874 |
| N | US LEC | 49,229 | 75,536 | 103,536 | 133,536 | 165,536 |
| O | USN | 172,000 | 226,000 | 276,000 | 346,000 | 426,000 |
| P | WinStar | 82,000 | 121,000 | 166,000 | 216,000 | 273,000 |
| Q | WorldCom (MFS) | <u>309,000</u> | <u>399,000</u> | <u>494,000</u> | <u>594,000</u> | <u>704,000</u> |
| R | Total CLEC | 1,671,889 | 2,184,311 | 2,749,729 | 3,388,729 | 4,100,729 |
| S | AT&T (Local)** | 295,573 | 322,917 | 360,417 | 402,917 | 457,917 |
| T | MCIMetro** | 295,573 | 322,917 | 360,417 | 402,917 | 457,917 |
| U | Sprint (Local)** | <u>73,893</u> | <u>80,729</u> | <u>90,104</u> | <u>100,729</u> | <u>114,479</u> |
| V sum(S-U) | Total LD | 665,039 | 726,563 | 810,938 | 906,563 | 1,030,313 |
| w, (R-V) | Total Lines In Service | 2,336,928 | 2,910,874 | 3,560,667 | 4,295,292 | 5,131,042 |
| | Sequential Growth | | 573,945 | 649,793 | 734,625 | 835,750 |
| US Access Line Share | | | | | | |
| X (our est) | Estimated 1998 US Access Lines | 170,000,000 | 172,000,000 | 174,000,000 | 176,000,000 | 177,000,000 |
| Y, (X-W) | Local Competitors' Share | 1.4% | 1.7% | 2.0% | 2.4% | 2.9% |
| Local Competitor Switched Revenue Share of US Local Market | | | | | | |
| Z (our est) | Monthly Local Switched Revenue Per Line | \$63.68 | \$64.00 | \$64.32 | \$64.64 | \$64.96 |
| AA (BB) | Estimated Switched Monthly Revenue (\$ Millions) | 148.8 | 186.3 | 229.0 | 277.7 | 333.3 |
| BB (our est) | Estimated Dedicated Monthly Revenue (\$Millions) | 100.9 | 111.9 | 122.6 | 132.1 | 142.6 |
| CC (AA-BB) | Total Monthly Revenue (\$Millions) | 249.8 | 298.2 | 351.6 | 409.8 | 476.0 |
| DD (CC*12) | Total Annualized Revenue (\$Millions) | 2,997.1 | 3,578.1 | 4,218.9 | 4,917.1 | 5,711.6 |
| EE (our est) | Estimated US Local Market | 100,000 | 101,000 | 102,000 | 103,000 | 105,000 |
| FF (DD/EE) | Share of Local Market at Quarter End | 3.0% | 3.5% | 4.1% | 4.8% | 5.4% |
| ii | Incremental Share of Local Market Gained During Quarter | | 0.55% | 0.59% | 0.64% | 0.67% |

*Excludes acquired lines: 1Q98:111,600 from Intermedia's acquisition of Shared Tech, 1,811 from NEXTLINK's acquisition of Start Technologies, 24,000 from WinStar's acquisition of Goodnet & Pachet; and 4Q97: 8,000 from McLeod's acquisition of Consolidated & 48,000 from ICG's acquisition of CBG.

** LD access line count based on 1997 switched revenues of \$100M AT&T, \$100M MCI, \$25M Sprint, and \$64 monthly revenue per line; and 1998 switched revenues \$300M AT&T, \$300M MCI, \$75M Sprint and \$65 monthly revenue per line.

Source: Merrill Lynch estimates

*Funding For Growth Initiatives
During 1Q Restrained Progress
On The EBITDA Front*

1Q EBITDA Results

CLEC EBITDA losses for the quarter were generally in line with our estimates (see Table 9 below). To varying degrees, the CLECs are all spending to fund growth initiatives including expanding capacity of access line installation and billing systems and increasing the size and depth of customer service operations. These costs are reflected in our full-year 1998 EBITDA estimates detailed in Table 10 below.

Table 9: Reported EBITDA Vs. Estimates

| | 1Q98E | 1Q98A | % Variance From Estimate |
|------------|--------|--------|--------------------------|
| ELI | (10.0) | (9.8) | 2% narrower |
| e.spire | NA | (11.6) | NM |
| ICG | (25.9) | (25.7) | 1% narrower |
| Intermedia | (4.6) | (9.8) | 113% wider |
| RCN | (11.6) | (9.6) | 17% |
| TCG | RSTR | 22.2 | RSTR |
| USN | (36.0) | (36.5) | 1% wider |

Source: Merrill Lynch estimates

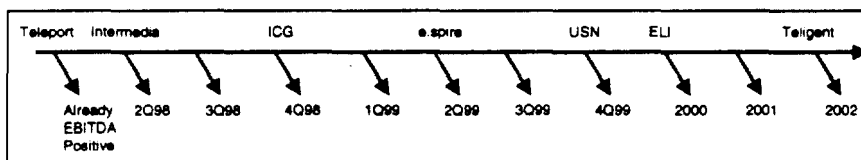
Table 10: EBITDA Full-year Estimates

| | 1997A | 1998E |
|------------|---------|---------|
| ELI | (22.9) | (48.7) |
| e.spire | (55.1) | (35.4) |
| ICG | (123.8) | (17.0) |
| Intermedia | (49.9) | RSTR |
| RCN | (7.7) | RSTR |
| TCG | 44.9 | RSTR |
| USN | (94.4) | (124.3) |

Source: Merrill Lynch estimates

We forecast EBITDA losses to lessen during the next few quarters as expenditures to support growth initiatives (i.e., enhanced back office systems and customer support personnel) taper off and the ability to leverage operating and SG&A expenses increases. As shown in Table 10 above and Chart 9 below, Teleport is currently the only CLEC we cover that is EBITDA positive, however, we forecast EBITDA breakeven to occur for Intermedia during 2Q and ICG during 4Q98.

Chart 9: EBITDA Breakeven Timeline



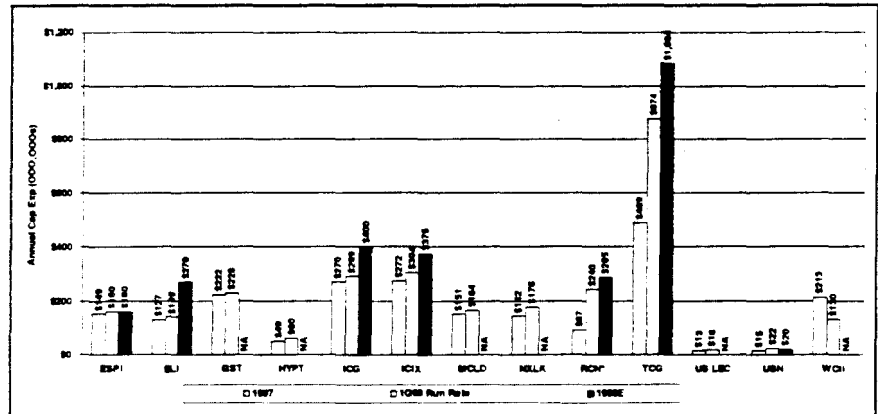
Source: Merrill Lynch estimates

■ Investment In Network Facilities

Capital Expenditures

We estimate that the CLECs spent approximately \$700 million on capital expenditures during 1Q, equating to an annualized run rate of approximately \$2.8 billion, and we forecast that full-year capital expenditures for the group will total \$3.2 billion.

Chart 10: Annual CLEC Capital Expenditure Estimates



Source: Merrill Lynch estimates and company reports

As detailed in Table 11 below, we estimate combined capital expenditures on local facilities for both the CLECs and the big 3 long distance companies will be \$5.2 billion for full-year 1998, an increase of 33% over the investment in local facilities made in 1997.

Table 11: Estimated CLEC Capital Expenditures

| (\$'s in Billions) | 1997 | 1Q98E Annualized Run Rate | 1998E |
|--------------------|-------|---------------------------|-------|
| CLECs | 2,199 | 2,802 | 3,200 |
| LD Co's | 1,700 | 1,800 | 2,000 |
| Total | 3,899 | 4,602 | 5,200 |
| % Change on 1997 | | 18% | 13% |

Source: Merrill Lynch estimates and company reports

6. Estimate Changes

We made the following changes to our forecasts after reviewing 1Q results. All have been previously published.

Electric Lightwave

We have revised our forecast of full-year 1998 revenue for Electric Lightwave due to company's indication that it is experiencing slower than anticipated provisioning of access lines from US West. As shown in Table 12 below, we have lowered our 1998 revenue estimate by 3% from \$103.3 million to \$100.5 million, however we are maintaining our EBITDA loss estimate for full-year 1998 of \$48.7 million.

Table 12: 1998E Electric Lightwave Revised Revenue Forecast

| (\$ in millions) | Prior | Revised | % Change |
|------------------------|-------|---------|----------|
| Local Switched | 25.3 | 31.6 | 24% |
| Long Distance Switched | 13.9 | 9.4 | -32% |
| Data | 18.0 | 18.0 | -- |
| <i>Network Access</i> | | | |
| Local | 32.2 | 29.0 | -10% |
| Long Haul | 13.8 | 12.4 | -10% |
| Total Network Access | 46.0 | 41.5 | -10% |
| Total Revenue | 103.3 | 100.5 | -3% |

Source: Merrill Lynch estimates

e.spire Communications

We made no changes to our estimates for e.spire.

ICG Communications

Although we were impressed by the growth in ICG's core CLEC business, we were disappointed with results from NETCOM (ICG's newly acquired internet services provider or ISP) and its network services division. As a result, we have lowered our 1998 and 1999 revenue and EBITDA estimates. As shown in Table 13 below, we have lowered our 1998 full-year revenue estimate by 3% from \$621.4 million to \$600.6 million while we increased our estimated EBITDA losses by \$14.8 million to \$31.8 million. For full-year 1999, we have lowered our estimated revenue by 3% from \$926.4 million to \$895.8 million and our estimated EBITDA by 6% from \$133.9 million to \$126.1 million.

Table 13: Revised ICG Forecasts

| (\$ in millions) | 1998E | | | 1999E | | |
|------------------|--------|----------|---------|-------|----------|---------|
| | Prior | New Est. | % Chng. | Prior | New Est. | % Chng. |
| CLEC | 279.7 | 288.7 | 3% | 523.0 | 525.0 | -- |
| NETCOM | 196.7 | 177.3 | -10% | 245.9 | 221.7 | -10% |
| Other* | 145.0 | 134.6 | -7% | 157.5 | 149.1 | -5% |
| Total Revenue | 621.4 | 600.6 | -3% | 926.4 | 895.8 | -3% |
| EBITDA | (17.0) | (31.8) | -87% | 133.9 | 126.1 | -6% |

*Note: Includes network services. Zycorn & satellite services (sale of division pending)

Source: Merrill Lynch estimates

Intermedia Communications

We are restricted from providing financial forecasts for Intermedia.

RCN Corporation

We are restricted from providing financial forecasts for RCN.

Teleport Communications Group

We are restricted from providing financial forecasts for Teleport.

USN Communications

As published on 6/10, due to slower than anticipated ramp up of telemarketing sales and enhanced services initiatives and lower direct salesforce productivity, we have lowered our 1998 and 1999 forecasts. As a result, we have lowered our private market value based price objective to \$18 and our intermediate term opinion from Accumulate to Neutral and our long term opinion from Buy to Accumulate.

7. Investment Conclusion

We Remain Bullish On CLEC Stocks As A Group, Continue To Recommend Electric Lightwave, E.spire, ICG, Teligent & USN.

We reiterate our long-standing bullish stance on the CLEC group viewing the recent stretch of stock price weakness as an excellent buying opportunity. Although restricted from comment on both Intermedia and RCN, we continue to highlight both e.spire and Teligent. Our stance on these two stocks is supported by both solid operational performance reported during 1Q98 and sizable stock price appreciation potential, based on our 12-18 month price objectives. In addition, we continue to recommend Electric Lightwave and ICG Communications.

Table 14: CLEC Stock Recommendations

| | Ticker | Opinion | Price 6/17/98 | Price Objective* | % Upside |
|-------------------------------|--------|---------|------------------|---------------------|-------------|
| Advanced Radio Telecom | ARTT | RSTR | \$11.75 | RSTR | NA |
| e.spire Communications | ESPI | D-2-1-9 | \$17.38 | \$28.00 | 61% |
| ICG Communications | ICGX | D-2-2-9 | \$31.75 | \$43.00 | 32% |
| Intermedia Communications | ICIX | RSTR | \$38.75 | RSTR | NA |
| RCN Communications | RCNC | RSTR | \$20.38 | RSTR | NA |
| Teleport Communications Group | TCGI | RSTR | \$58.44 | RSTR | NA |
| Teligent | TGNT | D-2-1-9 | \$28.00 | \$37.00 | 32% |

*Private market based valuation.
Source: Merrill Lynch estimates

e.spire, Our Newest Recommendation, With A 12-18 Month Price Objective of \$28 or 76% Upside

e.spire Communications

Our most recent recommendation is e.spire Communications, a facilities-based CLEC targeting small and medium-sized businesses in the southern US. e.spire was one of the first CLECs to offer its customers a fully integrated suite of both voice and data (including high speed internet) services. A new senior management team of experienced telecom executives was installed within the past 15 months in an effort to reposition the company to better execute this bundled services strategy. We reiterate our intermediate term Accumulate and long term Buy opinions for e.spire and maintain our \$28 12-18 month price objective based on our 10-year DCF model, assuming a 15% discount rate, a 9.5x multiple on terminal year EBITDA, no public market discount, and a 6.3-8.1% perpetual growth rate of unlevered free cash flow.

We Expect Teligent, To Hit Our \$37 Price Objective Or 30% Upside Over The Next 12-18 Months

Teligent

We reiterate our intermediate term Accumulate and long term Buy opinions for Teligent as its commercial service rollout appears to be running ahead of expectations with more than 10 cities now likely to be in commercial operation by year-end 1998 vs. our original expectation of 10 commercial cities by year end 1998. In preparation for widespread network deployment, Teligent currently has beta-test customers up and running on its fixed wireless point-to-multipoint network in Los Angeles and is utilizing the network to streamline its process and procedures for network deployment, customer installation and support. We are extremely encouraged by this development, as it reaffirms our confidence in Teligent's network deployment schedule. We maintain our \$37 12-18 month price objective based on our 10-year discounted cash flow (DCF) model, a 15% discount rate, a 9.0x multiple on terminal year EBITDA, no public market discount, and a 5.6% perpetual growth rate of unlevered free cash flow.

Electric Lightwave

We reiterate our intermediate and long term Accumulate opinion for Electric Lightwave and maintain our \$20 12-month price objective based on our 10-year DCF model which assumes a 15% discount rate, a 10x multiple on terminal year EBITDA, a 7.3% perpetual growth rate of unlevered free cash flow, and a 10% "haircut" to private market value for majority (83%) ownership by Citizens Utilities (CZN, \$10.44, C-3-2-9). We continue to forecast strong sequential growth for Electric Lightwave's core CLEC revenue, and expect sequential access line growth to increase during the next few quarters as local line provisioning capacity in US West territories ramps up.

ICG Communications

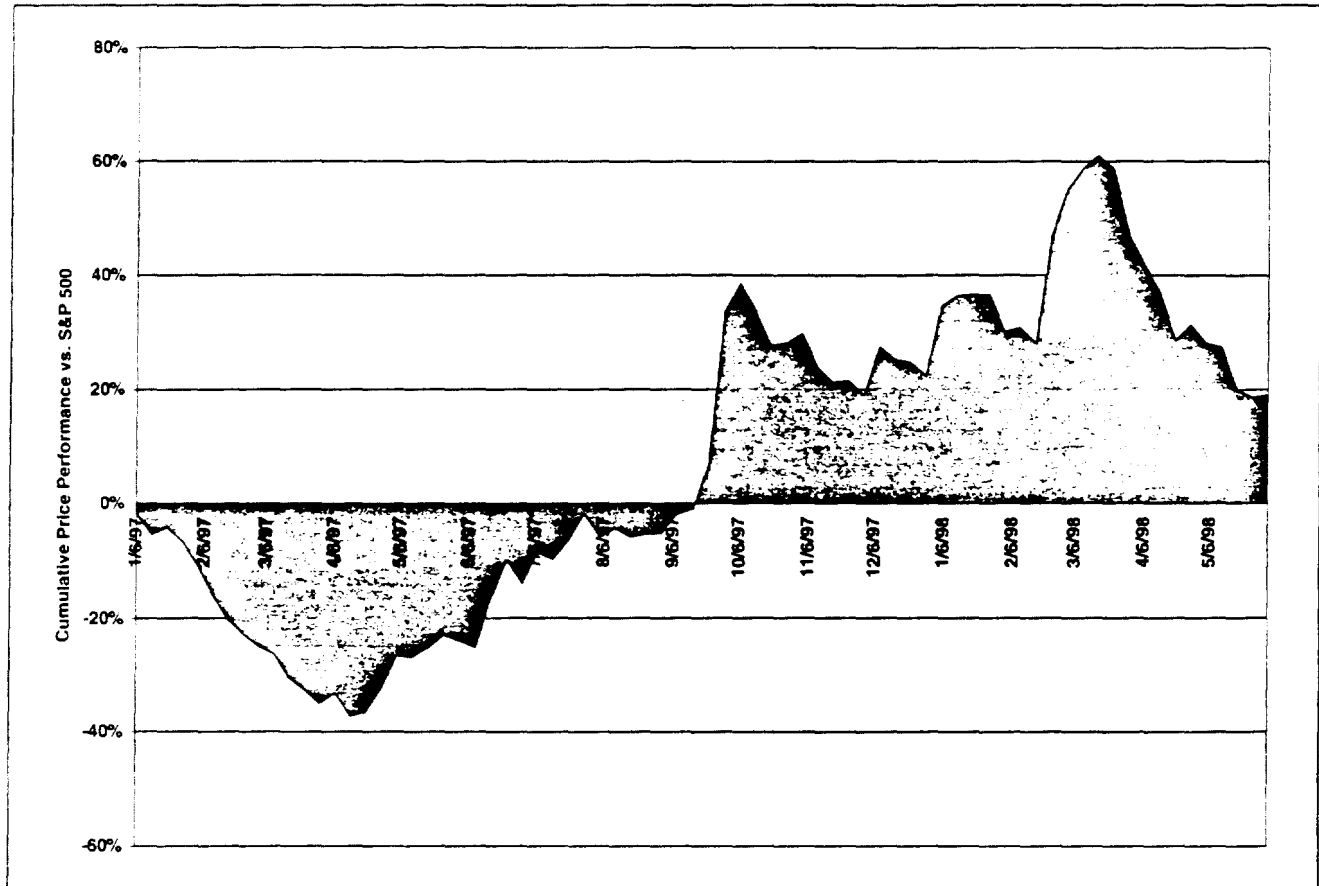
Our recommendation of ICG is supported by the continued strong growth in its core CLEC operations. Supporting this strong growth, 1Q net local access line additions for ICG of 45,100 were 13% better than our estimate which bodes well for ICG to meet our forecast of 341,000 lines by year-end 1998. ICG's improvement in core CLEC EBITDA was over-shadowed during 1Q, however, due to a wider than expected contribution to EBITDA loss from NETCOM (ICG's newly acquired internet services provider). We anticipate that EBITDA losses will decrease as the NETCOM division begins to show improvement during 3Q and that ICG will report positive EBITDA for 4Q98. We reiterate our intermediate and long term Accumulate opinion for ICG and maintain our \$42 12-month price objective based on our 10-year DCF model which assumes a 15% discount rate, a 9x multiple on terminal year EBITDA, no public market discount, and a 7.9% perpetual growth rate of unlevered free cash flow.

Recent Stock Price Trends

*CLEC Stocks Have Weakened
Recently After A Run Of
Impressive Stock Price
Performance Vs. The S&P 500*

After a number of strong relative price moves by the CLEC group vs. the S&P 500 during the late summer of 1997 and 1Q98 (see Chart 11 below), the group pulled back after a number of negative EBITDA forecast revisions prior to the 1Q98 reporting season. Intermedia and ICG figured most prominently in these negative forecast revisions for vastly different reasons. For Intermedia, the issue was higher than anticipated S.G. & A. costs associated with building back office infrastructure (i.e., billing and line provisioning systems) and headcount expansion to staff customer service and support operations. In the case of ICG, the fundamental issue was weaker than anticipated results from NETCOM, a recently acquired ISP.

Chart 11: CLEC Stock Price Performance Vs. S&P 500



*CLEC Stocks Have Tracked
The S&P Year-To-Date*

The CLEC group's recent price weakness that began in mid-March has contributed in a material way to the current negative wave of investor sentiment towards the group. As shown in Chart 12 below, CLEC stocks have declined 19.2% on average since the mid-March peak. As shown in Chart 13 below, *year-to-date, the CLEC group has tracked the S&P 500 with the average CLEC stock up 13.4% vs. 12.7% for the S&P 500.*

Chart 12: CLEC Relative Performance Since Highpoint On March 16

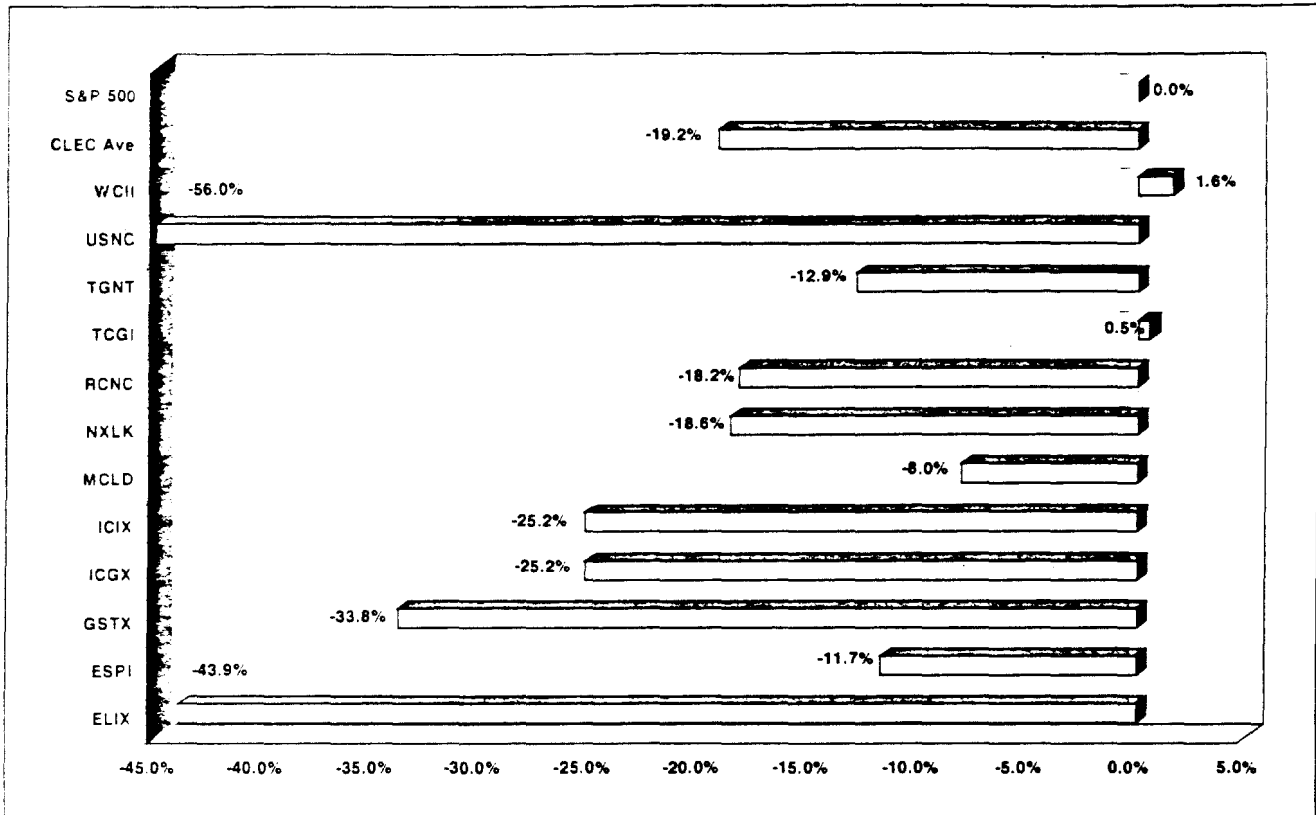
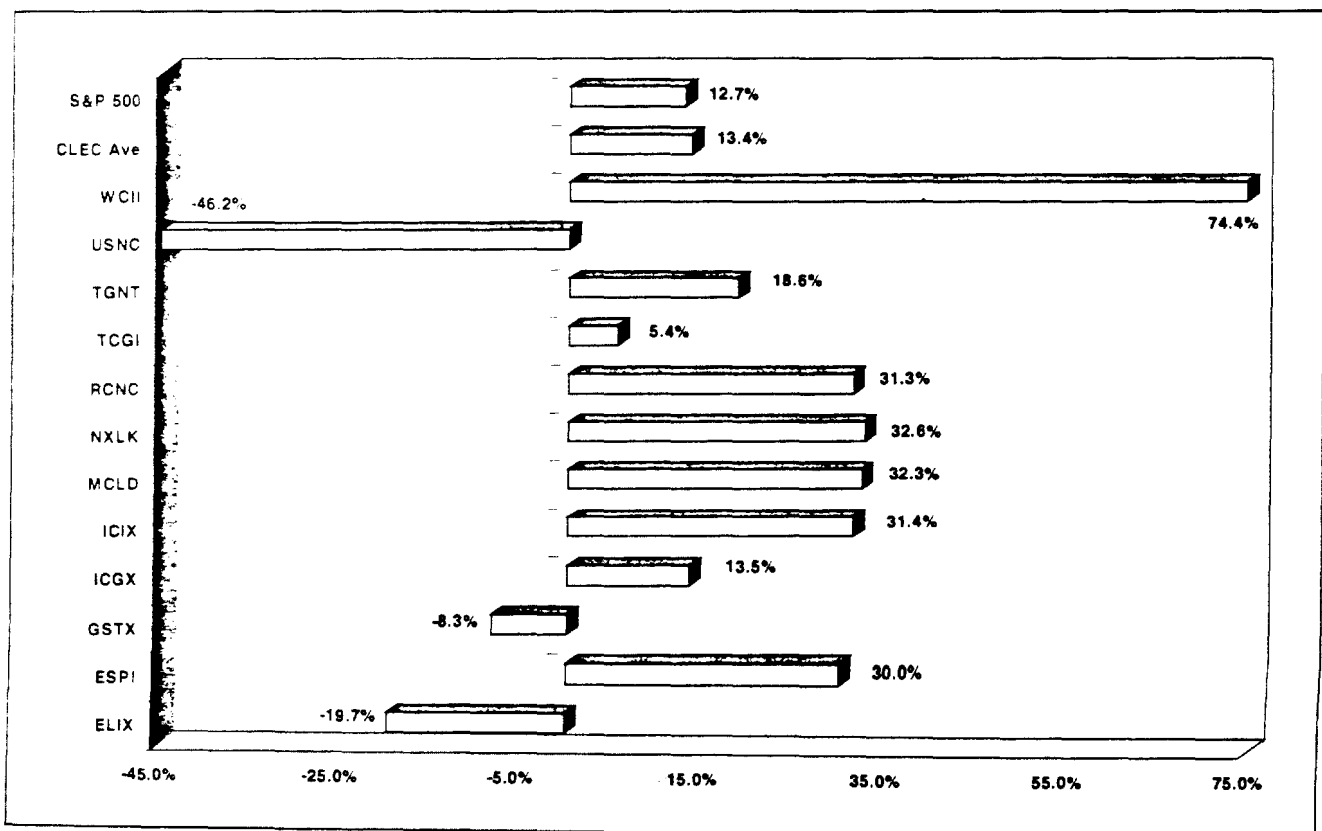


Chart 13: Year-To-Date Stock Performance as of June 12



*What "Surprises We Expect"
During The Coming Months
That Could Help Reverse
Recent CLEC Stock Price
Weakness...*

Potential CLEC Stock Price Catalysts

Year in, year out, one of the most difficult questions we receive from investors around the world is *"What surprises do you expect?"* On the surface, this question sounds like a humorous oxymoron but is instead meant to probe for potential near term stock price catalysts. Clearly, the recent CLEC stock price performance is indicative of a dearth of positive news in the group. We think this news drought is coming to an end and thus investor attention will reorient away from issues of negative forecast revisions and back towards a focus on key long-term "value drivers" such as new growth initiatives and continued operational progress at "core" CLEC operations. Below, we list our survey of *"surprises that we expect"* in the coming months:

■ Takeover, takeover, takeover

We continue to view the high potential for CLEC consolidation as one the most important themes underlying our long standing bullish outlook for CLEC stocks. Possible buyers of CLECs include:

1. **Other CLECs** looking to expand geographically, add new products and facilities as well as "bulking up" in the hopes of attracting a takeover bid themselves;
2. **Large long distance companies** interested in accelerating local market entry efforts as well as expanding the ability to offer customers full "end to end" product solutions;
3. **ILECs** looking to expand product expertise and to acquire "out of region" telecom facilities; and,
4. **Foreign telcos** interested in local telecom facilities in the US for the provision of multinational telecom services for large corporate customers demanding "end to end" network connectivity.

Table 15 below attempts to array key players on both sides of the takeover speculation game:

Table 15: Mergers & Acquisitions Matrix — Potential Buyers & Targets

| CLEC Target | Potential Buyer | Comment |
|---------------------------|--|---|
| Advanced Radio Telecom | WinStar, Teligent, AT&T, IXC, Qwest, Level 3, Williams | Purchase additional spectrum for local broadband services. Quickly expand network reach into local market. |
| e spire | Intermedia, NEXTLINK, WorldCom | Expand local/data service footprint in Southern US. |
| Electric Lightwave | GST, Intermedia, NEXTLINK | Expand local/data service footprint in Western US. |
| GST Communications | NEXTLINK | Expand local/data service footprint in Western US. |
| Hyperion | Intermedia, NEXTLINK | Expand local/data service footprint in Eastern US. |
| ICG Communications | Intermedia, NEXTLINK, WorldCom | Expand geographic footprint. Local facilities and Data presence. |
| Intermedia Communications | AT&T, WorldCom, Sprint, Bell Atlantic, US West, Amentech | Significantly bulk up data capabilities (esp. frame relay). Service customer base and expertise. Gain access to large Southeast-based customer base. |
| McLeod | AT&T | Expand local customer base into upper Midwest. |
| NEXTLINK | AT&T, Sprint, WorldCom | Expand local network presence. |
| RCN Corporation | AT&T, WorldCom, Sprint, SBC | Begin competing in residential market in the Northeast and Western US. |
| Teligent Corporation | AT&T, Sprint, WorldCom, NTT, British Telecom, Other Foreign Telcos | Utilize wireless spectrum to significantly expand reach into local market. Provide US-based last mile section of global on-net "End-to-End" service offering. |
| US LEC | Intermedia, e spire | Expand customer base in the Southeast US. |
| USN Communications | AT&T, Sprint, WorldCom, Teligent, WinStar, NEXTLINK | Rapidly expand customer base and salesforce in AIT and BEL region. Access to USN term and volume local resale agreements with RBOCs. Access to electronic interfaces with RBOCs. |
| WinStar | WinStar, Teligent, AT&T, IXC, Qwest, Level 3, Williams, Sprint, WorldCom, NTT, British Telecom, Other Foreign Telcos | Purchase additional spectrum for local broadband services. Quickly expand network reach into local market. Provide US-based last mile section of global on-net "End-to-End" service offering. |

Source: Merrill Lynch

■ More Alliances

Within the CLEC group, alliances with other telecom companies have taken many forms, ranging from the licensing of specialized telecom products, up to and including major joint marketing relationships as the basis for new strategic initiatives. An example of the latter includes the well publicized national (i.e., out-of-region and inter-LATA) wholesale data relationship struck between Intermedia and US WEST on 1/29/98 as well as a similar relationship recently announced between Intermedia and Ameritech. In fact, we expect that over the balance of 1998, similar deals will be announced between CLECs (most likely involving Intermedia) and other RBOCs (most likely Bell Atlantic).

We view these CLEC alliances as serving a number of important advantages for both parties including:

Table 16: Benefits From CLEC Alliances

| Benefit for the CLEC | Benefit for the telecom partner |
|---|--|
| 1) New revenue opportunity | 1) New revenue opportunity |
| 2) Low SG&A support required and thus potential for high margins | 2) Use alliance to stem competitive share loss via rapid new product introductions |
| 4) Leverage facilities investment required to support alliance for other CLEC opportunities in new geographic markets | 3) Use alliance to circumvent regulatory barriers |
| 4) Utilize alliance in marketing efforts to build credibility with potential customers | 4) Obtain access to CLEC facilities, especially first/last mile infrastructure |
| | 5) Possible first move towards a CLEC acquisition |

Source: Merrill Lynch

■ Progress towards profitability

Although investors, for some time, have focused attention on CLEC progress towards EBITDA break-even, this focus has been especially keen as of late given both the recent spate of negative forecast revisions leading into 1Q98 reporting season and the upcoming EBITDA inflection for a number of CLECs (See Chart 3 page 8). As the visibility of 2Q and 3Q98 EBITDA progress improves, we expect that investor sentiment will also lift.

Valuation Benchmarks

Discounted Cash Flow — Merrill Lynch's Preferred Valuation Methodology

In determining our target prices for the CLEC group shown in Table 17 below, we use a 10-year DCF (discounted cash flow) model with a terminal year EBITDA multiple of 9-10x, a 15% discount rate and an implied perpetual growth rate of free cash flow of approximately 7.0-7.5%. We strongly believe that as the larger CLECs such as MFS, TCG and Brooks Fiber have been acquired, the strategic local assets which the remaining CLECs bring to the table (i.e., local loop facilities, systems infrastructure, customer base, and a salesforce trained in selling local and data products) are growing in scarcity value while the CLECs' continued gain of local market share increases the fundamental value of these companies. We suspect the smaller CLECs will consolidate amongst themselves in order to gain the scale and scope which will attract an acquirer. The most likely buyers of CLECs include one of the large long distance companies, other CLECs looking to increase their local reach, or foreign-based telcos looking for "local presence" in the US and possibly, but less likely, ILECs desiring to move out of region.

*Our Valuation Work Relies
Heavily On DCF Analysis*